



EAST KENTUCKY POWER COOPERATIVE

June 8, 2005

HAND DELIVERED

Ms. Beth O'Donnell  
Executive Director  
Kentucky Public Service Commission  
P.O. Box 615  
211 Sower Boulevard  
Frankfort, Kentucky 40601

RECEIVED

JUN 08 2005

PUBLIC SERVICE  
COMMISSION

Re: Administrative Case No. 2005-00090

Dear Ms. O'Donnell:

Please find enclosed for filing with the Commission in the above-referenced case an original and six (6) copies of the testimony of Roy M. Palk pursuant to the Commission's Order of May 11, 2005.

Please contact me if you have any questions about this matter.

Very truly yours,

Charles A. Lile  
Senior Corporate Counsel

Enclosures

Cc: Parties of Record

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**COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION**

RECEIVED

JUN 08 2005

PUBLIC SERVICE  
COMMISSION

**In the Matter of:**

**AN ASSESSMENT OF KENTUCKY'S )  
ELECTRIC GENERATION, TRANSMISSION, ) ADMINISTRATIVE  
AND DISTRIBUTION NEEDS ) CASE NO. 2005-00090**

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**PREPARED TESTIMONY OF ROY M. PALK  
ON BEHALF OF  
EAST KENTUCKY POWER COOPERATIVE, INC.**

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**Q. Please state your name and business address.**

A. My name is Roy M. Palk and my business address is 4775 Lexington Road, Winchester, Kentucky 40391.

**Q. By whom are you employed and in what capacity?**

A. I am employed by East Kentucky Power Cooperative, Inc., ("EKPC") as President and Chief Executive Officer.

**Q. Has EKPC filed information in this case in response to data requests from the Public Service Commission (the "Commission")?**

A. Yes.

**Q. Is there any additional information that you believe that the Commission should consider in developing the Strategic Blueprint for the use and development of electric energy in Kentucky?**

A. EKPC believes that the information previously submitted in Administrative Case 387 as well as the data request responses submitted in the current Case 2005-00090 proceeding are comprehensive in nature and responsive to the inquiries from the Commission Staff.

1           However, the Kentucky Revenue Cabinet’s decision to ignore historic practice and  
2           precedent and to apply sales and use tax to certain EKPC-owned equipment and  
3           facilities used in manufacturing electricity, is of immediate concern to EKPC and our  
4           member systems, since these activities have always been considered exempt from such  
5           taxes. This attempted taxation will decrease Kentucky’s much envied competitive  
6           advantage in energy costs and is not consistent with the concept of providing reliable,  
7           affordable power to customers in Kentucky.

8   **Q.    What do you consider to be the top issues facing the electric power industry in**  
9   **Kentucky over the next 20 years?**

10  A.    It’s difficult to predict specific issues in such an ever-changing industry, particularly over  
11       the next 20 years. Consider the rise and fall of the deregulation movement in the past  
12       few, short years. Many states – and utilities – were quick to jump on the restructuring  
13       bandwagon. Kentucky, with its historically low rates, thankfully took a “wait and see”  
14       approach. While other states have paid for their mistakes – literally – Kentucky has been  
15       a shining example of excellent public policy, reasonable regulatory oversight, and sound  
16       utility management and investment.

17       Still, there are several emerging matters that will continue to affect our ability to provide  
18       reliable, affordable electricity. These can be grouped in three categories:

- 19           • *Increasing costs due to environmental compliance, rising costs of fuel, and*  
20            *meeting Kentucky’s growing demand for energy*
- 21           • *Research, development and deployment of advanced clean-coal technologies as*  
22            *part of a balanced energy portfolio*

- 1           • *Building, maintaining and operating a reliable transmission system to serve the*  
2           *families and businesses of Kentucky*

3 I will now address these three important subject matters in more detail.

4           **INCREASING COSTS**

5           Environmental Compliance

6           Environmental compliance requirements have had significant impact on electricity costs  
7           in recent years. A significant portion of EKPC’s capital investment since 1995 has been  
8           devoted to environmental compliance. An additional \$69 million has been spent recently  
9           on environmental compliance at the new E.A. Gilbert Generating Unit in Mason County.  
10          These costs will no doubt rise as more stringent federal laws and regulations are adopted.  
11          As a not-for-profit, consumer-owned electric cooperative, EKPC has strived to minimize  
12          costs throughout the years. For example, EKPC’s last base rate increase was in 1983.  
13          EKPC was also one of the last major electric utilities in Kentucky to apply for and  
14          receive approval for an environmental surcharge. This mechanism has helped utilities in  
15          this state to effectively manage the increasing costs to meet strict environmental  
16          requirements while continuing to use high-sulfur Kentucky coal. The surcharge also will  
17          enable utilities to manage future costs as the federal government mandates even more  
18          stringent emissions requirements.

19          Fuel Cost

20          Fuel cost is the single largest component of total electricity costs. Kentucky is blessed  
21          with abundant coal resources, which produce over 90 percent of its electricity. But the  
22          cost and availability of coal has been affected in recent years by consolidation of coal  
23          companies, bankruptcies, environmental permitting requirements, increased enforcement

1 of coal transportation, and other factors. In addition, natural gas prices are at an all-time  
2 high, resulting in higher fuel costs absorbed by customers during peak demand times.  
3 The enactment of the fuel adjustment clause regulation in 1978 has allowed utilities to  
4 adjust rates without going through a general rate case – saving administrative and  
5 regulatory costs. This mechanism has enabled utilities to weather the recent steep  
6 increases in fuel costs by flowing through prudently incurred costs to customers.  
7 However, the FAC also has proven to be a valuable mechanism for consumers during  
8 periods of lower fuel costs. For example, during the late 1980s and into the 1990s,  
9 customers received an immediate, direct benefit of reductions in fuel costs as a result of  
10 the mechanism.

#### 11 Growing Demand for Energy

12 There also is increased cost due to system growth and demand for electricity. EKPC's  
13 member distribution systems as a group are adding more consumers than any other  
14 electric utility in the state – due to the strong growth in our member systems' rural and  
15 suburban service territory – and are growing at twice the rate of the national average.

16 Household usage has been growing at a significant rate. Central air conditioning, once  
17 seen as a luxury, is now more common. New homes are bigger and armed with more  
18 electricity-consuming appliances, like TVs, computers, and heat pumps.

19 Growth, however, comes with a price. EKPC is planning to invest more than \$1.5 billion  
20 in generating and transmission facilities by 2010. We have applied for certificates of  
21 convenience and public necessity to construct two clean-coal baseload generating units,  
22 and we plan to build or upgrade several hundred miles of transmission lines by the end of

1 the decade. All of this is being built to serve our growing demand for energy within the  
2 Commonwealth. We expect this trend to continue in the next 20 years.

### 3 **CLEAN-COAL TECHNOLOGIES**

4 Kentucky's low electric rates provide major economic and societal benefits for the  
5 Commonwealth. Low rates are a key competitive advantage in attracting jobs and  
6 industry, while low electric bills help maintain and improve the quality of life for our  
7 people. It is imperative, therefore, that we ensure the Commonwealth a continuing  
8 supply of low-cost, reliable electricity. EKPC believes Kentucky's future depends on the  
9 research, development and deployment of clean-coal technologies.

10  
11 The deployment of advanced clean-coal technologies can have a beneficial impact.  
12 Clean-coal technology makes it possible to satisfy environmental objectives while  
13 meeting energy needs. An example is the deployment of advanced coal conversion  
14 technologies such as circulating fluidized bed (CFB) and integrated gasification  
15 combined cycle (IGCC) generation. IGCC and other advanced technologies, while  
16 technically sound, face capital and operating cost uncertainties. Kentucky should provide  
17 initiatives to research and mitigate these uncertainties, such as developing public-private  
18 partnerships, to encourage advanced technology deployment.

19  
20 Kentucky should look at the possibility of providing seed capital to partner with industry  
21 in the early high-risk stage of clean-coal project development. This stage involves  
22 process design, engineering design, capital and operating cost estimation and  
23 environmental compliance work, all of which determine the feasibility of a project.

1 Kentucky should also consider providing financial support to offset premium or non-  
2 competitive energy costs derived from the uncertainty and risk of pioneering these  
3 advanced technologies. Such support could take the form of a contribution to capital and  
4 could have repayment provisions that are tied to project performance. This financial  
5 support could be provided without a drain on the general fund by using a revenue bond  
6 that is retired from severance tax revenues generated by the project.

7 Clean-coal technologies also help ensure that coal remains a primary fuel source for the  
8 utility industry, by far its largest consumer. This will help Kentucky by maintaining low  
9 electric rates, part of the foundation of our standard of living and a key economic  
10 development advantage.

11  
12 EKPC is a proven state leader in advancing clean energy from new clean-coal conversion  
13 technologies. Three clean-coal plants are in separate phases of development – an  
14 investment of more than \$1.3 billion in Kentucky.

- 15 • In March, EKPC opened the state’s first, fully operational clean-coal CFB  
16 generator – the E.A. Gilbert Unit at our Spurlock Station in Mason County.
- 17 • In October 2004, EKPC applied for a certificate of convenience and public  
18 necessity for Gilbert’s sister unit, called Spurlock Station Unit 4. It is scheduled  
19 to begin operation in 2008, when the Warren Rural Electric Cooperative will  
20 become a member-owner of the EKPC system. This will add eight counties and  
21 more than 56,000 members to the EKPC system.
- 22 • In January, EKPC applied for a certificate for an identical CFB generator in Clark  
23 County – J. K. Smith No.1. It is scheduled to begin operation in 2009.

1 These units will be the cleanest power plants in Kentucky and among the cleanest in the  
2 country. The CFB technology also allows for expanded use of Kentucky coals, with each  
3 unit capable of burning up to 1.2 million tons a year. Coal is provided by companies in a  
4 competitive-bidding process to determine the lowest-cost option.

5  
6 At the same time, EKPC knows it makes good economic and environmental sense to  
7 develop clean alternatives to traditional energy sources as part of a balanced energy  
8 portfolio.

9 EKPC and its member systems are marketing renewable energy under the voluntary  
10 “*EnviroWatts – Earth Friendly Energy Alternatives*” program. EKPC is the first and only  
11 utility in Kentucky that operates landfill gas generation from captured methane. EKPC  
12 operates three plants in Boone, Laurel and Greenup counties and is working on  
13 development of several others. These plants, while small, generate electricity by using  
14 gas that was formerly being flared. In addition to the landfill gas projects, EKPC is also  
15 testing the feasibility of wind generation.

16 EKPC believes that Kentucky’s energy policy should encourage the production and use  
17 of “green” energy from renewable resources. “Green” energy is not necessarily the  
18 lowest-cost electricity, and often does not fit a least-cost rate regulatory model.

19 However, from an environmental perspective, it is a desirable alternative for which many  
20 consumers are willing to pay.

21 Due to the limited availability and higher cost of renewable energy, EKPC does not  
22 believe that Kentucky should mandate a Renewable Portfolio Standard (RPS). Policies  
23 that encourage the use of higher-cost renewable energy, such as the voluntary approach

1 discussed above, should be used, and utilities should manage renewable portfolios in  
2 response to market demand.

### 3 **A RELIABLE TRANSMISSION SYSTEM**

4 The transmission grid is the lifeline of the electric utility system. Deregulation resulting  
5 in a restructured wholesale market and surging demand have created tremendous  
6 pressures on a transmission grid that was not designed to meet the needs of today's  
7 market. The Kentucky transmission grid was originally created as an in-state  
8 transportation facility to be used to serve Kentucky customers. The state's transmission  
9 system faces an increasing need for expansion and upgrade. Demand and reliability  
10 require that this be done quickly. While everyone demands an abundant and reliable  
11 supply of electricity, more and more landowners are increasingly reluctant to allow new  
12 transmission facilities on their property.

13  
14 Regulations that govern the right to construct and site transmission lines should be  
15 reviewed and streamlined. They must eliminate uncertainty and minimize costs prior to  
16 certification. Expeditious decisions that prevent delays and increased costs are essential.  
17 It is extremely important that these guidelines do not place regulated utilities that serve  
18 Kentuckians at a competitive disadvantage with non-regulated merchant plants that ship  
19 power out-of-state.

20  
21 EKPC believes Regional Transmission Organizations, or RTOs, may have operationally  
22 advantages but cost disadvantages. Kentucky should try to prevent its utilities from being

1 required to join an RTO, but allow them to join only if it is deemed to be economically  
2 prudent.

3 The development of RTOs, as well as the August 2003 blackout that struck the Midwest  
4 and Northeast, have resulted in changes in the way electric utilities are operating their  
5 transmission systems. As a result of the August 14, 2003 blackout, the National Electric  
6 Reliability Council (NERC) has undertaken an extensive process to rewrite reliability  
7 standards for the nation's electric utilities. These new standards, in combination with the  
8 opening of the new Midwest Independent System Operator (MISO) energy market, are  
9 changing the way Kentucky's electric utilities operate. At EKPC, the MISO market and  
10 its member companies' systems are affecting daily operations today more than ever  
11 before. EKPC System Operators are routinely being asked to reconfigure EKPC's  
12 transmission system or to redispatch its lower cost generation and economy purchases to  
13 higher cost resources to accommodate Transmission Loading Relief (TLR) called for by  
14 MISO and its member companies. This type of operation not only compromises the  
15 reliability of transmission service to our consumers but also raises their cost of electricity.

16  
17 As a recent example, the TLR procedure was invoked by MISO to relieve congestion on  
18 what MISO defines as the "Northeast Kentucky Interface." This resulted in the closing of  
19 market interfaces being used by EKPC to make hourly purchases for the sake of  
20 economy. Curtailment of these lower cost purchases meant bringing higher cost  
21 combustion turbines on-line to replace these transactions. Previously filed responses cite  
22 similar scenarios where EKPC economic operation and transmission reliability has been  
23 compromised by MISO activities.

1 The lack of coordination between MISO and other regions with respect to scheduled  
2 generation outages, and allowing additional North to South flows, has also compounded  
3 problems on Kentucky's transmission system. Without additional investment in  
4 transmission within the MISO and other major market participant's systems to alleviate  
5 market created transmission congestion, EKPC operations will continue to be adversely  
6 impacted.

7 **Q. What barriers do you believe exist, if any, to meeting the investment needs for**  
8 **electric industry infrastructure in Kentucky?**

9 A. Most of the significant barriers have been identified in the discussion above. They  
10 include:

- 11 • Ignoring historic precedent concerning application of sales and use taxes on  
12 electric facilities
- 13 • Increasing cost of environmental compliance, with additional emissions  
14 requirements under consideration by the federal government
- 15 • Rising cost of fuels, including coal and natural gas
- 16 • Financial and operating risks associated with deployment of the next generation  
17 of clean-coal technologies, specifically Integrated Gasification Combined Cycle  
18 (IGCC)
- 19 • Timely construction of transmission lines to serve Kentucky customers
- 20 • Development and impact of RTOs on Kentucky's transmission grid

21 **Q. Do you have any other advice to offer the Commission in its development of the**  
22 **electric energy Strategic Blueprint for Kentucky?**

1 A. A comprehensive and robust energy policy is necessary as Kentucky moves to build a  
2 stronger and healthier economy, while supporting and enhancing the quality of life for its  
3 families and businesses. We applaud the governor in his efforts to develop Kentucky's  
4 first comprehensive energy policy, and the formation of the new Office of Energy Policy,  
5 which EKPC has recommended.

6 As noted herein, EKPC has a critical interest in Kentucky's energy future. EKPC is the  
7 only regulated utility with an advanced clean-coal facility in operation, with two more in  
8 development. Our environmental leadership and renewable energy efforts are second to  
9 none. And, as a locally owned cooperative, our mission is to ensure that Kentucky  
10 families and businesses have enough reliable, affordable power. EKPC believes that the  
11 State of Kentucky shares that mission and would like to work with the State to  
12 accomplish it.

13 We appreciate the opportunity for input and look forward to working with the new Office  
14 of Energy Policy, the Public Service Commission and the Governor in answering further  
15 questions or providing any additional information.

16 **Q. Does this conclude your testimony?**

17 A. Yes.

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

AN ASSESSMENT OF KENTUCKY'S )  
ELECTRIC GENERATION, TRANSMISSION, ) ADMINISTRATIVE  
AND DISTRIBUTION NEEDS ) CASE NO. 2005-00090

PREPARED TESTIMONY OF ROY M. PALK  
ON BEHALF OF  
EAST KENTUCKY POWER COOPERATIVE, INC.

A F F I D A V I T

STATE OF KENTUCKY )  
 )  
COUNTY OF CLARK )

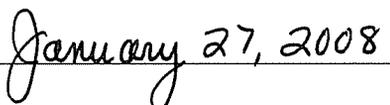
Roy M. Palk, being duly sworn, states that he has read the foregoing prepared testimony and that he would respond in the same manner to the questions if so asked upon taking the stand, and that the matters and things set forth therein are true and correct to the best of his knowledge, information and belief.

  
\_\_\_\_\_  
Roy M. Palk

Subscribed and sworn before me on this \_\_\_7th\_\_\_ day of June, 2005.

  
\_\_\_\_\_  
Notary Public

My Commission expires:

  
\_\_\_\_\_